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PAINTED PONY PETROLEUM LTD.

07 Enter the Pony

ANNUAL REPORT TO SHAREHOLDERS

CORPORATE INFORMATION

Painted Pony Petroleum Ltd is a public junior oil and gas exploration company based in Calgary, Alberta, Canada. The Company closed its initial public offering and commenced trading on the TSX Venture Exchange in May 2007. Painted Pony's corporate philosophy is to grow through exploration and development drilling complemented by both corporate and asset acquisitions. The Company's long term target is to maintain a balanced crude oil and natural gas emphasis.

ANNUAL AND SPECIAL MEETING

Painted Pony Petroleum Ltd. invites shareholders and interested parties to attend its Annual and Special Meeting to be held at the Viking Room at the Calgary Petroleum Club, 319 - 5th Avenue SW, Calgary, Alberta on Wednesday, June 4th, 2008 at 3:00 pm (Calgary time). Shareholders not attending the meeting are encouraged to complete the form of proxy and forward it at their earliest convenience.

GLOSSARY

/d	per day
boe	barrels of oil equivalent (6 mcf of Natural gas = 1 barrel of oil equivalent)
bbls	barrels
mboe	thousand barrels of oil equivalent
mbbl	thousand barrels
mcf	thousand cubic feet
WTI	West Texas Intermediate, a benchmark crude oil used for pricing comparison

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Cover painting "Painted Ponies" by Paul Van Ginkel (www.paulvanginkel.com)

FINANCIAL AND OPERATIONAL HIGHLIGHTS

FINANCIAL		**2007**
Revenue (before transportation, interest and other)	$	782,843
Funds flow from operations [1]	$	602,956
Per share - basic and diluted	$	0.07
Net earnings	$	157,448
Per share - basic and diluted	$	0.02
Capital expenditures, net	$	6,057,508
Net working capital	$	16,250,793
Total assets	$	26,194,023
Shares outstanding		
Basic - Class A		15,282,700
Basic - Class B		1,173,600
Weighted average shares		
Basic - Class A		7,280,725
Basic - Class B		738,512
Basic Class A after deemed conversion of Class B [2]		9,262,083
OPERATIONAL		
Volumes		
Oil sales - daily *(bbls/d)*		25
Oil sales - total *(bbls)*		9,160
Sales prices (before transportation)		
Oil *($/bbl)*		85.46
Total proved and probable reserves *(mbbls, 6:1)*		553.0
Wells drilled		
Gross		6
Net		2.41
Net success rate *(%)*		100

(1) This table contains the term funds flow from operations, which should not be considered an alternative to, or more meaningful than cash flow from operating activities as determined in accordance with Canadian generally accepted accounting principles ("GAAP") as an indicator of the Company's performance. Therefore reference to funds flow from operations or funds flow from operations per share (basic and diluted) may not be comparable with the calculation of similar measures for other entities. Management uses funds flow from operations to analyze operating performance and leverage and considers funds flow from operations to be a key measure as it demonstrates the Company's ability to generate the cash necessary to fund future capital investment. The reconciliation between, funds flow from operations and funds flow from operating activities can be found in the Management's Discussion and Analysis. Funds flow from operations per share is calculated using the basic and diluted weighted average number of shares for the period after the deemed conversion of the Class B shares to Class A shares.

(2) The deemed conversion of Class B shares to Class A was calculated utilizing a deemed current trading price of $3.72, the weighted average trading price per share of Class A shares for the last 30 consecutive trading days. Class B shares are convertible into Class A shares by the formula whereby the weighted number of Class B shares are multiplied by the factor determined by dividing the last 30-day weighted average trading price of Class A shares.

TO OUR SHAREHOLDERS

The Bakken reservoir is a widespread marine dolomitic sandstone deposit that covers over 100 townships (3,600 square miles) of land within S.E. Saskatchewan. The formation has long been known to contain very significant light oil reserves; however, this vast resource base was not exploited aggressively, due to the formation's very low porosity and permeability, and marginal economics. Four years ago, it became apparent to the founders of Painted Pony that equivalent formations in the United States were now being successfully exploited using two rapidly evolving technologies: horizontal drilling and fracture stimulation techniques.

The application of this theory was tested through the drilling of the initial S.E. Saskatchewan horizontal wells into the Bakken reservoir. These wells proved up the play, and the companies were able to pursue an extensive multi-well developmental drilling program. The Bakken play is now the largest light oil discovery in Canada in the last 50 years.

In the fall of 2006, we set up Painted Pony in order to further pursue our vision. By this time, oil prices had risen to unprecedented heights and the new technologies had continued to evolve. We began assembling a team of seasoned industry professionals, covering all the requisite oil and gas disciplines - land, geology, geophysics, engineering, administrative and financial. With the completion of two significant farm-in deals providing access to over 55,000 net acres of land, a good deal of which is prospective for light sweet oil in the Bakken reservoir, Painted Pony was ready to hang out the "open for business" sign.

We completed an initial public offering and a subsequent private placement on May 17, 2007, raising approximately $13.5 million before costs; the shares began trading on the TSX Venture Exchange shortly thereafter. During the ensuing seven months of 2007, Painted Pony operated the drilling of the first six (2.4 net) wells with 100% success; five of these wells targeted sweet light Bakken oil. In so doing, Painted Pony satisfied all of its initial drilling commitments and began earning lands on its two main farm-in deals in this core area.

The Company has been able to accomplish a great deal since beginning operations. The main focus has been the further delineation of this vast resource play; our in-house mapping suggests that there may be as much as four to eight billion barrels of original oil in place in the S.E. Saskatchewan Bakken reservoir. The Company has identified an initial inventory of over 200 development and low risk exploratory drilling locations, all on company-accessible lands and all targeting light sweet oil. Our 2008 fiscal year could see up to approximately 50 gross Bakken horizontal wells drilled.

Other accomplishments of 2007 include:

- *closing a bought deal financing on December 6, 2007 for proceeds of $10 million of common equity at $2.40 per Class A share;*
- *gaining access to over 1,200 square kilometers of 3D seismic and 1,200 km of 2D seismic in our second core area, N.E. British Colombia;*
- *exiting the year with 120 bbls/d of high netback light sweet oil production;*
- *adding 553,000 bbls of proved and probable reserves, all with the drill bit;*
- *operating all of our properties; and*
- *achieving netbacks of $62/bbl in 2007, among the highest in our industry, with operating and transportation costs of only $11/bbl.*

TO OUR SHAREHOLDERS

Moving into 2008, the Company continued an active operated drilling program in the first quarter, drilling 11 gross (3.74 net) horizontal Bakken wells at a 100% success rate. Painted Pony has continued to expand its land base in S.E. Saskatchewan, with two additional large farm-in deals totaling more than 13,800 net acres adjacent to our Midale property and focused on Bakken light oil. The Company has also accumulated 100% WI in 20 sections (12,800 net acres) of crown and freehold rights on exploratory Bakken trends that will be further delineated in 2008. In addition to the 200 Company-mapped horizontal drilling locations targeting the Bakken formation for light sweet oil, Painted Pony also has a number of locations for other light oil reservoirs in S.E. Saskatchewan. In pursuit of the Company's goal of growing rapidly in S.E. Saskatchewan, the Company now has access to a large land base prospective for light oil in the Bakken and other formations of approximately 87,000 net acres.

In March 2008, Painted Pony announced and closed a strategic acquisition of 450 boe/d of natural gas and natural gas liquid production and 89,600 net acres of developed and undeveloped land in N.E. British Columbia. The acquisition area is very familiar to the management team and is over 50% operated by Painted Pony. There is a vast resource of multi-zone tight gas formations under and adjacent to the lands. There is also a good infrastructure of under-utilized pipelines and gas plants already in the area. Access is year round for the most part, excluding spring breakup. An active program of drilling, completions and tie-ins is currently under way by our partner, the operator of the balance of the lands. Over the next few months, Painted Pony will plan an exploration and development program for the balance of 2008 and into 2009. The acquisition provides a great launching point in this high impact gas-prone area.

While Painted Pony estimates that most of its near-term growth will be derived from developing its Saskatchewan Bakken properties, the new northeastern British Columbia assets give the Company another potential high impact growth area as gas prices continue to strengthen.

Since entering the public markets less than a year ago, the Company has been able to successfully execute on all elements of the detailed business plan. These achievements would not have been possible without the efforts of the management, staff, directors and their families. With 25% of the issued and outstanding shares owned by management and directors, all are fully engaged in the success of the Company. Recognition is also due to Painted Pony's partners, suppliers, and government agencies; their cooperation and assistance has been vital to achieving each milestone. Finally, Painted Pony wishes to acknowledge our shareholders for their support and encouragement in 2007 through the initial startup phase of the Company's existence "Enter the Pony".

On behalf of the Board of Directors,

Sincerely,

Patrick R. Ward
President & Chief Executive Officer
April 1, 2008

REVIEW OF OPERATIONS

Painted Pony commenced operations in June of 2007 following the completion of its initial public offering and private placement at the end of May. At that time, the Company had two large farm-in agreements in S.E. Saskatchewan and access to a large seismic data base within N.E. British Columbia. The business plan was to explore for high-quality, light sweet oil in Saskatchewan and utilize the seismic information in seeking high impact, multi-zone sweet gas in B.C.

During 2007, Painted Pony drilled a total of five (1.91 net) horizontal oil wells targeting the Bakken formation and one (0.5 net) vertical oil well targeting the Midale formation in Saskatchewan. Production of light crude oil from Saskatchewan commenced in August of 2007, and by year end sales totalled 9,160 bbls (25 bbls/d on an annual basis). By the end of 2007, the Company had accumulated 295 net developed and 6,310 net undeveloped acres. Operations during 2007 in British Columbia focused on evaluating the seismic data base, as the Company reviewed the relative strength of the anticipated medium and near term commodity prices.

FOCUS AREAS

Since that time, in less than a year, the Company has expanded its operations through conventional drilling, farm-in agreements, asset acquisitions and successful bidding at crown land sales. Significant strides have been achieved in both core areas. By the end of March 2008, Painted Pony had in less than one year of existence:

- *In S.E. Saskatchewan:*
  - *- Drilled 16 (5.65 net) horizontal wells and one (0.5 net) vertical well to date with a 100% success rate;*
  - *- Gained access to 87,000 net acres of land through land sales, drilling promotions and farm-in arrangements; and*
  - *- Production for the third week of March 2008 averaged 325 bbls/d of light oil based on field estimates, with three gross (1.2 net) wells not on production due to spring break-up.*

- *In N.E. British Columbia:*
  - *- Gained access to 1,200 m^3 of three dimensional and 1,200 m^3 of two dimensional seismic data;*
  - *- Acquired 89,600 net acres of developed and undeveloped land through an acquisition; and*
  - *- Production mid March 2008 is estimated at 450 boe/d; 2,580 mcf/d of gas and 20 bbls/d of NGLs, based on field estimates.*

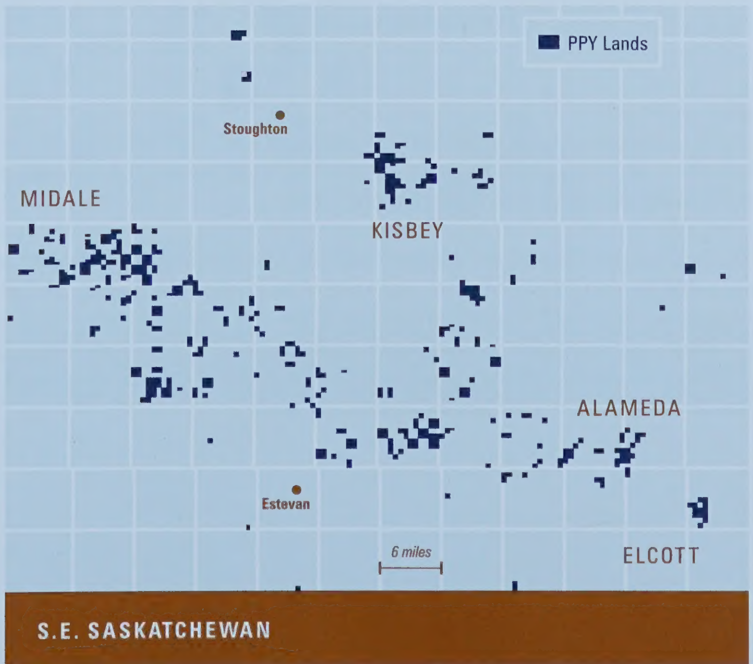
S.E. SASKATCHEWAN

Painted Pony's operations in Saskatchewan are located in the general area west of the town of Weyburn and north of Estevan. Painted Pony gained initial access to lands in the area through two large farm-in agreements in 2007 in the Midale and Kisbey areas. This general area is prospective for high netback, light sweet oil from the Bakken, Midale, Frobisher, Alida and Birdbear formations.

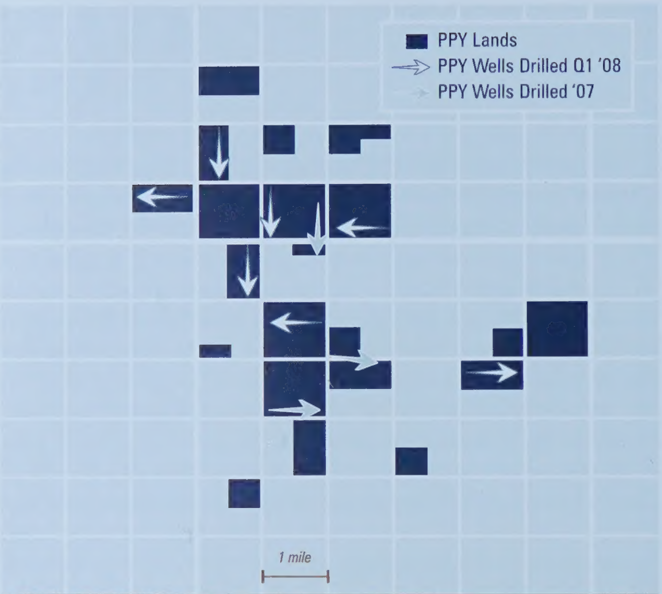
The Bakken reservoir is a widespread marine dolomitic sandstone deposit that covers over one hundred townships (3,600 square miles) of land within S.E. Saskatchewan. The formation has long been known to contain very significant light oil reserves; however, this vast resource base has not been exploited aggressively, due to the formation's very low porosity and permeability, and marginal economics. Four years ago, equivalent formations in the United States began to be successfully exploited using two rapidly evolving technologies: horizontal drilling and fracture stimulation techniques. The application of this theory was then tested by industry players in S.E. Saskatchewan, with the drilling of initial horizontal wells into the Bakken reservoir. These wells helped to prove up the play, and extensive multi-well developmental drilling programs were developed.

Painted Pony's main focus in S.E. Saskatchewan is light sweet oil in the Bakken formation, with activity in 2007 focused in the Midale and Kisbey areas. As of December 31, 2007, Painted Pony had drilled five (1.9 net) operated horizontal wells targeting the Bakken formation and one (0.5 net) vertical well in the Alameda area targeting the Frobisher and Midale formations.

To date, Painted Pony has drilled 16 (5.65 net) horizontal wells into the Bakken zone. Currently, 12 (4.0 net) of these are producing and three (1.16 net) additional wells are expected to be on production after spring breakup. Activity during the 2008 fiscal year could see up to 50 gross (22 net) Bakken horizontal wells drilled.



REVIEW OF OPERATIONS



KISBEY AREA DRILLING

KISBEY

Painted Pony acquired its interests in the Kisbey area through a January 7, 2007 farm-in agreement for 5,764 gross (4,323 net) acres of land to evaluate Bakken potential in the Kisbey area. As a part of the initial public offering, this farm in agreement was transferred to the Company as part of the restructuring transactions at that time.

Kisbey production is located northeast of the town of Estevan, Saskatchewan. The Kisbey area produces 43 degree API light oil from the Bakken formation.

In June 2007 the Company commenced horizontal drilling of its first light sweet oil well, paying 37.5% of the cost of drilling the test well to earn a 26.25% working interest in an earning block comprised of two gross sections of the farmor's lands. As of December 31, 2007 Painted Pony had drilled three gross (0.9 net) wells under the Farmout Agreement. To date, Painted Pony has drilled 10 (2.75 net) horizontal Bakken oil wells in the Kisbey area.

At the end of Q1 2008, the Company's land position is 10.5 gross (2.6 net) sections. Painted Pony plans to pursue development drilling comprised of up to 32 additional gross (8.0 net) wells on these lands.

MIDALE

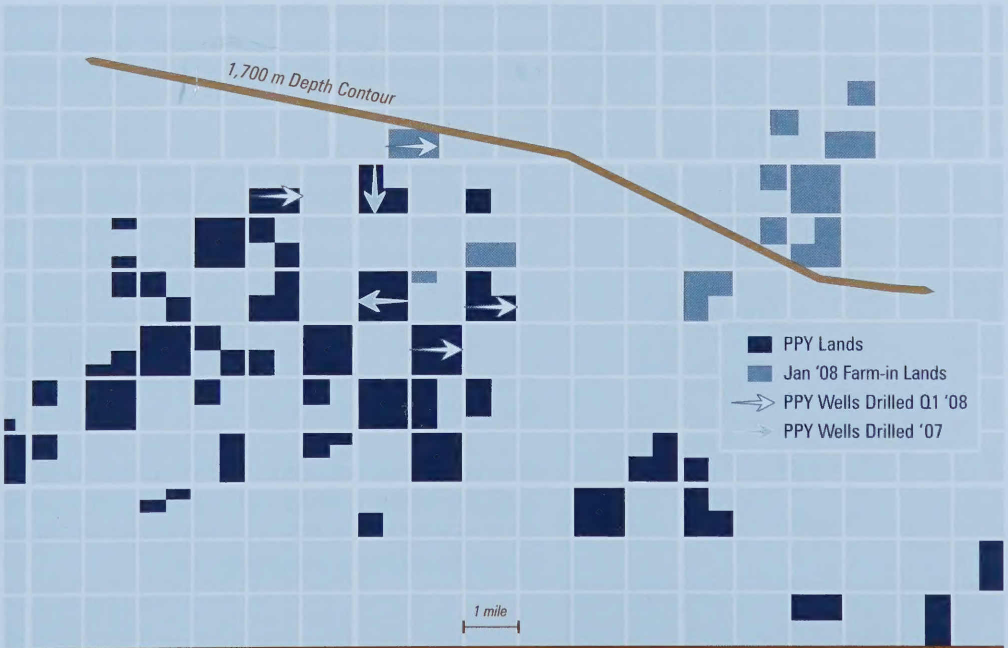
Midale production is located southwest of the town of Weyburn, Saskatchewan. The Midale area produces 43 degree API light oil from the Bakken formation. As of December 31, 2007, Painted Pony had drilled two (1.0 net) wells at Midale. At Midale, six (2.9 net) horizontal Bakken wells have been drilled to the end of Q1 2008.

Painted Pony acquired its interests in the Midale area through a March 2007 Midale/Elcott Farm-in Agreement involving 56,320 gross acres to evaluate potential oil from the Bakken zone. As a part of the initial public offering, this farm-in agreement was transferred to the Company as part of the restructuring transactions at that time. With each test well, the agreement provided for the earning of 100% of farmor's working interest subject to a non-convertible gross overriding royalty and two gross sections earning. The Midale area of the farm-in block saw industry competitors pay up to $2,750/acre for a total of $53 million for offsetting and nearby lands at the October, 2007 Saskatchewan Land Sale.

In January of 2008, Painted Pony expanded its exposure in the Midale area by executing an additional farm-in agreement allowing access to 3,280 gross (2,904 net) acres in the Midale area. Under the terms of the agreement, Painted Pony will pay 60% to earn 40% in the lands. The Company has committed to drill four wells on the farm-in lands. The first earning well was drilled in Q1 2008.

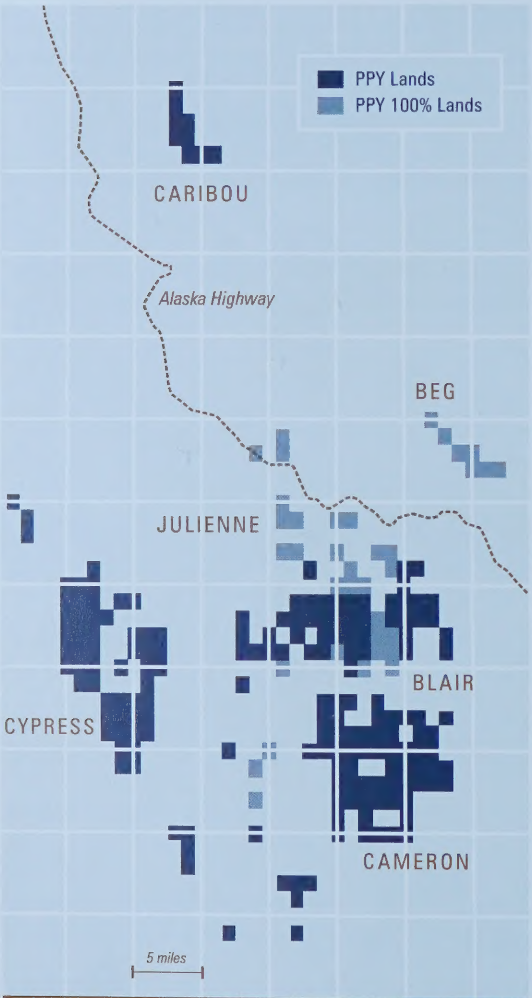
On the lands in the two farm-in agreements, the Company has mapped an additional 59 (approx 23.6 net) Bakken horizontal drilling locations.

In March of 2008 Painted Pony further expanded its land position by executing another farm-in agreement and extending north of Midale allowing access to 13,280 gross (10,907 net) acres of prospective lands. The Company has committed to drill two gross (1.3 net) wells in Q2 2008 on this project.



MIDALE AREA DRILLING

REVIEW OF OPERATIONS



N.E. B.C. ACQUISITION

N.E. BRITISH COLUMBIA

On March 31, 2008, effective February 1, 2008, Painted Pony closed a strategic acquisition of assets with sales of 450 boe/d of natural gas and natural gas liquid and 176,500 gross (89,600 net) acres of developed and undeveloped land located in N.E. British Columbia along the Alaska Highway corridor. The Company has existing large three dimensional seismic data over significant portions of the lands and has identified multiple low risk development and exploratory locations on the seismic data. Over 50% of the acquired properties are operated by Painted Pony and are very familiar to the management team. Painted Pony believes there is a vast resource of multi-zone tight gas formations under and adjacent to the lands. There is a good infrastructure of roads, under-utilized pipelines and gas plants already in the area. Access is year round for the most part, excluding breakup.

An active program of drilling, completions and tie-ins is currently under way by the Company's partner, the operator of the balance of the lands. In March 2008, two (0.55 net) wells were drilled in the Blair area and are cased as potential gas wells, of which one (0.2 net) is currently being completed and two (1.0 net) previously drilled gas wells are being tied-in within the Cameron area. Over the next few months, Painted Pony plans to further evaluate these properties in consultation with our key partner to plan activity for Q3 and Q4 2008.

Although the new northeastern British Columbia assets give the Company another potential high impact growth area as gas prices recover, Painted Pony's primary growth will continue to be from developing the Bakken properties.

LAND

Painted Pony's philosophy of growth through the drill bit is reliant upon the identification of new areas potentially prospective for crude oil. As the prices of purchasing land through crown land sales continues to become more expensive, Painted Pony is focused on the early identification of land prospective for Bakken before costs escalate as the competition from other larger industry competitors intensifies. Additionally, farm-in agreements provide another more economic means whereby the Company can gain access to lands to allow for the continual generation of future drilling locations.

As at December 31, 2007, in a report prepared by Seaton-Jordan and Associates Ltd., the Company had 6,310 net undeveloped acres in Saskatchewan valued at $2,288,745 and an option to earn various interests in 59,493 acres of other lands in Saskatchewan, valued at $36,259,137 for a 100% gross working interest. Seaton-Jordan's assessment of the Company's lands was prepared in accordance with National Instrument 51-101.

By the end of March 2008, the Company estimates it has access to approximately 87,000 net acres of land in Saskatchewan through farm-ins, crown land sales, and earning land through drilling operations. In British Columbia, with the closing of the asset acquisition, Painted Pony has 89,600 net acres of developed and undeveloped land.

RESERVES

Painted Pony's reserves were evaluated by McDaniel & Associates Consultants Ltd. ("McDaniel's"). effective as at December 31, 2007 in a report dated March 7, 2008. The Reserves Sub Committee of the Board of Directors is comprised of independent board members appointed by the Board of Directors of Painted Pony. The Committee has reviewed the report in accordance with its mandate.

The McDaniel's report was prepared in accordance with National Instrument 51-101 Standards of Disclosure for Oil and Gas Activities ("NI 51-101"). This instrument adopted by the Canadian Securities Administrators, sets out standards of disclosure for oil and gas activities and mandates the application of evaluation standards defined in the Society of Petroleum Evaluation Engineers (SPEE) Canadian Oil and Gas Evaluation Handbook (COGEH). The information that follows has been derived from the McDaniel's evaluation.

The estimates of reserves are subject to revisions as additional reservoir and performance information become available, and contain judgments of future events for which the actual results may vary materially. The reader is referred to the Company's Statement of Reserves Data and Other Oil and Gas Information Form, which it is anticipated will be filed before the end of April 2008 on the Company's website and on www.sedar.com. This Annual Report contains extracts of Painted Pony's reserves only.

At December 31, 2007 the Company's proved and probable working interest reserves, using forecast prices and costs, were 553.0 mboe, all light and medium oil. At December 31, 2007, Painted Pony's total proved working interest reserves were 201.7 mbbl and proved producing reserves were 77.7 mbbl.

SUMMARY OF RESERVES[(1)]
As at December 31, 2007

	Light/medium oil (mbbl)		Total oil equivalent (mboe)[(4)]	
Reserves category	**Gross**[(2)]	**Net**[(3)]	**Gross**[(2)]	**Net**[(3)]
Proved				
Developed producing	77.7	66.8	77.7	66.8
Developed non-producing	-	-	-	-
Undeveloped	124.0	111.8	124.0	111.8
Total proved	201.7	178.5	201.7	178.5
Probable	351.3	294.4	351.3	294.4
Total proved plus probable	553.0	472.9	553.0	472.9

(1) Numbers in this table are subject to rounding error.
(2) "Gross" means Painted Pony's total working interest reserves before royalties owned by others.
(3) "Net" means Painted Pony's total working interest reserves after deducting amounts attributable to royalties owned by others.
(4) Natural gas is converted to barrels of oil equivalent ("boe") at a ratio of six thousand standard cubic feet to one barrel of oil.

Both "gross" reserves (being working interest reserves, excluding royalty interest reserves, before deduction of royalty burdens payable) and "net" reserves (being working interest reserves and royalty interests less royalty burdens payable) are disclosed. The reserve reports were prepared utilizing definitions as set out under National Instrument 51-101.

NET PRESENT VALUE OF FUTURE NET REVENUE

The forecast prices used in the reserve report effective December 31, 2007 were McDaniel's published forecast prices and costs as at January 1, 2008. The constant prices used were McDaniel's posted constant prices as at December 31, 2007.

The estimated future net revenues are stated before deducting future estimated site restoration costs and reduced for estimated future well abandonment costs, the Saskatchewan Capital Tax and estimated capital for future development associated with the reserves.

In the reserve report, the net total future capital required to bring undeveloped proved and probable reserves onto production is estimated to be $9,974,800 over the life of the reserves.

Summary of pricing and inflation rate assumptions
Forecast prices and costs
As at January 1, 2008

	WTI Cushing Oklahoma *($US/bbl)*	Edmonton Par price 40 degree API *($Cdn/bbl)*	Inflation rates *(%/year)*	Exchange rate *($US/$Cdn)*
2008	90.00	89.00	2.0	1.000
2009	86.70	85.70	2.0	1.000
2010	83.20	82.20	2.0	1.000
2011	79.60	78.50	2.0	1.000
2012	78.50	77.40	2.0	1.000
2013	77.30	76.20	2.0	1.000
2014	78.80	77.70	2.0	1.000
2015	80.40	79.30	2.0	1.000
2016	82.00	80.80	2.0	1.000
2017	83.70	82.50	2.0	1.000
2018	85.30	84.10	2.0	1.000
2019	87.00	85.80	2.0	1.000
2020	88.80	87.50	2.0	1.000
2021	90.60	89.30	2.0	1.000
2022	92.40	91.10	2.0	1.000
Thereafter	+2%/yr	+2%/yr	2.0	1.000

RESERVES

Summary of net present values of future net revenue [1],[2],[3]
Forecast prices and costs *($000s)*
Before income taxes[2]**, discounted at** *(%/year)*

	As at December 31, 2007				
	0%	**5%**	**10%**	**15%**	**20%**
Proved					
Developed producing	3,802.6	3,535.5	3,309.5	3,117.1	2,952.1
Developed non-producing	-	-	-	-	-
Undeveloped	2,966.0	2,385.6	1,916.9	1,536.2	1,224.0
Total proved	6,768.6	5,921.2	5,226.4	4,653.3	4,176.1
Probable	10,978.6	8,644.0	6,921.0	5,614.4	4,597.9
Total proved plus probable	17,747.2	14,565.2	12,147.4	10,267.8	8,774.0

(1) Numbers in this table are subject to rounding error.
(2) Values are net of abandonment liabilities.
(3) The net present values of future net revenue do not represent fair market value.

RESERVE LIFE INDEX

The reserve life index is calculated by dividing reserves as at the effective date of the report (December 31, 2007) by the production during the applicable period, and represents a measure of the amount of time production could be sustained at the production rates based on the reserves at the applicable point in time. Based upon the year-end reserve volumes and the average fourth quarter 2007 production rate for Painted Pony, sufficient reserves exist to continue production at the current rate for approximately 16 years based on proved and probable reserves, and six years based on proved reserves.

Reserve life years	Proved	Proved and probable
Natural gas	-	-
Crude oil and NGLs	5.8	16.0
Total boe	5.8	16.0

RESERVE RECYCLE RATIO

The reserve recycle ratio is calculated by dividing the operating netback (being sales less royalties, transportation and operating costs) on a per unit basis by the finding and development cost. This indicator of efficiency measures the deployment of operating cash flow income compared to reserve additions.

	2007
Operating netback *($/boe)*	62.06
Proved basis	1.3
Proved and probable basis	2.2

PRODUCTION REPLACEMENT RATIO

The production replacement ratio measures the number of times the fourth quarter's production annualized has been replaced by net reserve additions. Painted Pony's production replacement ratio reflects the addition of reserves at a cost effective rate.

	2007
Proved basis	6.1 x
Proved and probable basis	16.3 x

The following Management's Discussion and Analysis ("MD&A") of financial results as provided by the management of Painted Pony Petroleum Ltd. ("Painted Pony" or the "Company") should be read in conjunction with the consolidated financial statements for the period ended December 31, 2007. This commentary is dated March 31, 2008. The financial data presented is in accordance with Canadian generally accepted accounting principles in Canadian dollars, except where indicated otherwise. These documents and additional information about Painted Pony are available on SEDAR at www.sedar.com.

Management's Discussion and Analysis contains the term funds flow from operations, which should not be considered an alternative to, or more meaningful than cash flow from operating activities as determined in accordance with Canadian generally accepted accounting principles ("GAAP") as an indicator of the Company's performance. Therefore, reference to funds flow from operations or funds flow from operations per share (basic and diluted) may not be comparable with the calculation of similar measures for other entities. Management uses funds flow from operations to analyze operating performance and considers funds flow from operations to be a key measure as it demonstrates the Company's ability to generate the cash necessary to fund future capital investment. Funds flow from operations per share is calculated using the basic and diluted weighted average number of shares for the period, and after deemed conversion of Class B shares into Class A. The Company calculates funds flow from operations as follows:

		Period ended December 31, 2007
Cash provided by operating activities	$	166,548
Changes in non-cash working capital		436,408
Funds flow from operations	$	602,956

Management's Discussion and Analysis also contains other terms, such as net working capital position and operating netbacks, which are not recognized measures under GAAP. Management believes these measures are useful supplemental measures of, firstly, the total net position of current assets and liabilities the Company has and, secondly, the amount of revenues received after royalties, transportation and operating costs. Readers are cautioned, however, that these measures should not be construed as alternatives to other terms such as current and long-term debt or net income determined in accordance with GAAP as measures of performance. Painted Pony's method of calculating these measures may differ from other companies, and accordingly, may not be comparable to measures used by other companies.

FORWARD-LOOKING STATEMENTS

This MD&A contains forward-looking statements relating to future events. In some cases, forward-looking statements can be identified by words such as "anticipate", "continue", "estimate", "expect", "forecast", "may", "will", "project", "should", "believe", or similar expressions. These statements represent management's best projections, but undue reliance should not be placed upon them as they are derived from numerous assumptions. These assumptions are subject to known and unknown risks and uncertainties, including the business risks discussed in the MD&A, which may cause actual performance and financial results to differ materially from any projections of future performance or results expressed or implied by such forward-looking statements.

These risks and uncertainties include, but are not limited to, the following:

- *Normal risks common to the oil and natural gas industry, including various operational risks in the carrying out of exploration, development and production operations,*
- *Risks and uncertainty of oil and gas geological deposits,*
- *Revisions, amendments or changes to capital expenditure plans including exploration, development and exploitation projects,*
- *Risks as to the availability and pricing of appropriate financing alternatives, and*
- *Potential changes in income tax regulations, governmental policies, rules, practises or approval process changes, or delays, or enhancements.*

Accordingly, readers are cautioned that events or circumstances could cause results to differ materially from those predicted. From time to time, Painted Pony's management makes estimates and forms opinions on which the forward-looking statements are based. The Company assumes no obligation to update forward-looking statements if circumstances, management's estimates, or opinions change.

OVERVIEW

From incorporation on August 12, 1999, the Company was a provider of web, logistics, financial and marketing services to U.S. merchants servicing the international market. In October 2002, a partnership agreement was entered into with Canada Post to jointly operate the Company's merchant activities. This partnership interest was disposed of in 2005. In November 2005, the auction business was sold. At that time the Company ceased to carry on active business, as it reorganized its affairs.

In February 2007, the Company entered into a series of agreements whereby it reorganized itself. The Company was continued into Alberta under the Business Corporation Act (Alberta), "ABCA", and articles of amendment were filed effecting name changes. All of the assets and liabilities were sold or assigned, and a private placement consisting of 240,000 common voting shares and a convertible debenture in the principal amount of $347,500 was completed. The convertible debenture was secured, bore interest at the rate of 5% per annum during the first two years of its term and at bank prime rate plus 3% thereafter and was convertible into common non-voting shares of the Company at a price of $0.15625 per common non-voting share. The Company created an unlimited number of non-voting common shares and consolidated the issued common shares on the basis that up to 2,500 of such shares became one common share. The Company then had 196 issued and outstanding common voting shares.

On March 27, 2007, the Company entered into a financing agreement ("Financing Agreement") pursuant to which the Company reconstituted the Company's board of directors, reorganized the share capital of the Company and filed articles of amendment to change the name to Painted Pony Petroleum Ltd., all of which were approved by the shareholders of the Company on March 29, 2007 and which were effected on April 3, 2007.

The 196 issued and outstanding common voting shares were exchanged for:

(i) 29,400 issued and outstanding Class A shares on the basis of 150 Class A shares for each existing common voting share, and
(ii) 6,615 issued and outstanding Class B shares on the basis of 33.75 Class B shares for each existing common voting share.

Completion of the reorganization of the Company, as contemplated in the Financing Agreement was conditional upon the closing of the initial public offering, which occurred on May 17, 2007.

Painted Pony commenced commercial operations on April 3, 2007 upon completion of a financial reorganization as part of an overall restructuring of the Company. Pursuant to "Comprehensive Revaluation of Assets and Liabilities" of the Canadian Institute of Chartered Accountants ("CICA") Handbook, the Company is entitled to use "fresh start" accounting which means that prior or comparative financial information is not required to be presented, as it would not be meaningful to the reader. Accordingly, financial information is presented commencing on April 3, 2007. Consequently, comparative financial information for the balance sheet, statements of operations and cash flows is not presented.

On May 23, 2007, subsequent to completion of an initial public offering on May 17, 2007, the Class A shares and Class B shares of Painted Pony Petroleum Ltd. began trading on the TSX Venture Exchange under the symbols "PPY.A" and "PPY.B" respectively. Painted Pony then commenced an active operated exploration program, focused on S.E. Saskatchewan and N.E. British Columbia.

NET EARNINGS AND FUNDS FLOW FROM OPERATIONS

Painted Pony generated funds flow from operations of $602,956 for the period ended December 31, 2007. Basic and diluted funds flow from operations per share are $0.07 for the period.

Painted Pony produced earnings of $157,448 for the period ended December 31, 2007. Basic and diluted earnings per share are $0.02 for the period.

SALES

During the period ended December 31, 2007, production generated 9,160 barrels of light crude oil (60 bbl/d based on actual production days of 153), of which approximately 94% was during the fourth quarter of the period. Crude oil sales were from four gross wells (1.65 net wells) in the Midale, Kisbey and Alameda areas of Saskatchewan. Revenue (before transportation costs) from sales of crude oil totalled $782,843 for the period ended December 31, 2007. The Company received an average price of $85.46/bbl, or approximately 2% less than the fourth quarter Edmonton light reference price.

To date, Painted Pony has not undertaken any hedging or commodity price contracts.

Transportation costs of $43,400 were approximately 5.5% of gross revenues, reflecting the trucking costs of hauling oil to the various sales points to compensate for occasional capacity issues.

Revenue

		Period ended December 31, 2007
Light crude oil sales	$	782,843
Transportation		(43,400)
Net	$	739,443

Average commodity prices

Exchange rate *(US$/Cdn$)*	- 2007 annual average		0.9351
WTI *(US$/bbl)*	- 2007 annual average	$	72.27
Edmonton par - light oil *($/bbl)*	- 2007 annual average	$	77.06
Exchange rate *(US$/Cdn$)*	- Q4 2007 average		1.0197
WTI *(US$/bbl)*	- Q4 2007 average	$	90.77
Edmonton par - light oil *($/bbl)*	- Q4 2007 average	$	87.18
Painted Pony's average price, before transportation *($/bbl)*		$	85.46

ROYALTIES

For the period ending December 31, 2007, total royalties were $112,285, or approximately 14.3% of sales (before transportation costs), reflecting the combined impact of freehold royalties and gross overriding royalty obligations along with low crown royalties due to the Saskatchewan crown royalty incentive programs.

Royalties by type

		Period ended December 31, 2007
Crown royalties	$	7,751
Freehold royalties		59,730
Gross overriding royalties		44,804
	$	112,285

PRODUCTION EXPENSES

For the period ended December 31, 2007, production expenses totalled $58,609, or an average of $6.40/bbl. Operating costs include operator charges, fuel, power and costs to treat emulsion, reflecting costs to process the incremental water in the initial post frac period. The Company anticipates overall operating cost levels to remain at this approximate level in the near future, reflecting similar costs for future potential new production adds.

OPERATING NETBACKS

For the period ended December 31, 2007, field operating netbacks averaged $62.06/bbl. Strong light crude oil commodity prices combined with crown royalty incentives are the primary contributing factor to this positive unit price.

Field operating netback

		Period ended December 31, 2007
Sales	$	85.46
Transportation		(4.74)
Royalties		(12.26)
Production expense		(6.40)
Field operating netback	$	62.06

GENERAL AND ADMINISTRATIVE

Net general and administrative expenses for the period ended December 31, 2007 were $364,012, of which $56,756 were costs assumed in May 2007 pursuant to the Financing Agreement, as set out in the May 8, 2007 long form prospectus (a copy of which can be viewed at sedar.com, or by contacting the Company). Total general and administrative costs, prior to capitalization and recoveries were for salaries and consulting costs from May 16, 2007 for six full-time and three part-time people (seven full-time and two part-time people at December 31, 2007), office rent and parking, computer software licenses and rentals. During the second half of 2007, the Company began recovering costs from operating wells and capital activities.

General and administrative costs

		Period ended December 31, 2007
Gross costs	$	916,674
Capitalized		(399,107)
Recoveries		(153,555)
Net costs	$	364,012

As at December 31, 2007, Painted Pony had not granted any options, hence there was no provision for stock-based compensation costs.

INTEREST AND OTHER INCOME

Painted Pony invests cash in short-term term deposits. These activities generated $350,227 of interest income during the period ending December 31, 2007. Also in the period, the Company purchased $70,601 of tubular pipe required in frac operations, which it charges to company-operated fracs on a rental basis, on terms consistent with industry standards, generating $48,192 of rental income during the period. Management expects that as the funds obtained through the placement of Class A and Class B shares is expended, interest income will diminish.

DEPLETION, DEPRECIATION AND ACCRETION

Depletion, depreciation and accretion expense for the period ended December 31, 2007 was $445,508 reflecting depletion charges and accretion provisions as the Company commenced production. Painted Pony has not excluded from the depletion calculation any costs for undeveloped properties or undeveloped land.

Depletion, depreciation and accretion costs

		Period ended December 31, 2007
Depletion	$	435,473
Depreciation		7,583
Accretion		2,452
Total	$	445,508

Depreciation expense of $7,583 was incurred in the period ended December 31, 2007 on office equipment, computer hardware and software, and office furniture determined on a 20% per annum declining balance basis.

Depletion rates reflect the incremental capital costs incurred by the Company in comparison to the revenue interest, as Painted Pony earned the land position in the farmout lands drilled on during the period. The Company expects that, in future periods, as the promotion phase in farmouts ends and the capital and revenue working interests more closely approximate each other, the depletion rate should benefit from this.

CAPITAL EXPENDITURES

On June 22, 2007 the Company commenced active oil and gas operations on its two major farm-in agreements with the drilling of its first crude oil well in the Kisbey area of Saskatchewan.

By the end of December 2007, Painted Pony completed drilling six gross, 2.89 net capital interest (2.41 net revenue interest) light oil wells in Saskatchewan. Of the six wells drilled, three (0.91 net revenue interest) horizontal Bakken formation light oil wells were located in the Kisbey area, two (1.0 net revenue interest) horizontal Bakken formation oil wells were at Midale and one (0.50 net revenue interest) vertical Midale formation well was at Alameda.

Subsequent to the end of the year, the Company has drilled 11 gross, 4.16 net capital interest (3.74 net revenue interest) successful Bakken horizontal wells in the Company's core areas in Saskatchewan.

Capital expenditures

		Period ended December 31, 2007
Lease acquisitions and retention	$	103,722
Drilling and completion costs		5,285,596
Facilities and equipment		589,895
Exploration and development		5,979,213
Head office expenditures		78,295
Total expenditures	$	6,057,508

The Company incurred capital expenditures of $6,057,508 during the period ended December 31, 2007. Painted Pony continues to develop its land base through earning land by drilling operations and participation at crown land sales. At December 31, 2007, the Company had approximately 6,310 net acres of undeveloped land in S.E. Saskatchewan.

At the end of December 2007, the Company had a commitment to drill four gross (2.4 net capital interest) wells in Saskatchewan by the end of June 2008, pursuant to a farm-in agreement with an industry competitor, at an estimated net cost for Painted Pony's interest of approximately $3.78 million.

In 2008, pursuant to a farm-in arrangement with an industry competitor, the Company has committed to drill two (1.3 net) wells in Saskatchewan at an estimated net cost to Painted Pony of $1.95 million. The farm-in agreement is subject to a non-performance penalty of $0.5 million per well.

At December 31, 2007, the Company has invested a total of $78,295 in other assets, specifically computer hardware and software, and office furniture and fixtures. Of these, $30,189 of other assets was assigned to the Company pursuant to the Financing Agreement, whereby all of the assets and liabilities were transferred to the Company immediately prior to closing of the initial public offering.

For the period ending December 31, 2007, the Company capitalized general and administrative expenses in the amount of $399,107, relating to exploration and development activities.

CEILING TEST

The Company calculates a ceiling test quarterly and annually whereby the carrying amount of petroleum and natural gas properties is compared to estimated future cash flow from the production of proved reserves. In 2007, the ceiling test was performed in accordance with the requirements of the CICA AcG-16 "Oil and Gas Accounting - Full Cost".

The Company performed a ceiling test calculation at December 31, 2007 resulting in undiscounted future cash flows from proved reserves and unproved properties exceeding the carrying amount of oil and gas assets. Consequently, no impairment in oil and gas assets was identified.

At December 31, 2007, the Company calculated the ceiling test using a weighted average price of $81.25 for light gravity crude oil.

The future prices used in the ceiling test calculation are based on a benchmark commodity price forecast used by the Company's independent reserve evaluators as follows:

	WTI crude oil (US$/bbl)	Edmonton light oil (C$/bbl)	US/CAN exchange rate (US$/CAN$)
2008	90.00	89.00	1.00
2009	86.70	85.70	1.00
2010	83.20	82.20	1.00
2011	79.60	78.50	1.00
2012	78.50	77.40	1.00
2013	77.30	76.20	1.00
2014	78.80	77.70	1.00
2015	80.40	79.30	1.00
2016	82.00	80.80	1.00
2017	83.70	82.50	1.00
2018	85.30	84.10	1.00
2019	87.00	85.80	1.00
2020	88.80	87.50	1.00
2021	90.60	89.30	1.00
2022	92.40	91.10	1.00
Thereafter	+ 2%/yr	+ 2%/yr	1.00

Adjustments were made to the benchmark prices for purposes of the ceiling test to reflect varied delivery points and quality differentials in the products delivered.

CAPITAL RESOURCES

As at December 31, 2007, Painted Pony has no long-term debt or credit facilities. Subsequent to year end, Painted Pony secured a $7.5 million demand revolving credit facility and a $5.0 million demand non-revolving acquisition/development facility with a Canadian chartered bank. Interest is payable at the lender's prime rate plus one quarter percent (0.25%) on the demand revolving facility and at the lender's prime rate plus one half percent (0.50%) on the demand non-revolving facility. A standby fee is charged on one eighth of one percent (0.125%) on the undrawn portion of the credit facilities. Security is provided by a first fixed and floating charge debenture of $50 million. Painted Pony has provided a negative pledge and undertaking to provide fixed charges over major petroleum and natural gas reserves in certain circumstances.

The availability under the demand revolving credit facility is restricted to $4.0 million pending close of an asset acquisition, and the facilities are subject to an interim review date of May 31, 2008 and an annual review on or before May 31, 2009.

Share capital

On May 17, 2007, the Company sold 12,000 units at a price of $1,000 per unit for gross proceeds of $12.0 million (the "Offering"). Each unit was comprised of 400 Class A shares and 90 Class B shares issued on a "flow-through" basis. Share issue costs were $1,046,545.

Subsequent to the closing of the Offering, Painted Pony issued 386,600 Class A shares and 86,985 Class B shares to a third party in satisfaction of the $347,500 convertible debenture and other debt in the amount of $619,000 (the "Debt Satisfaction").

Immediately after the closing of both the Offering and the Debt Satisfaction, a non-brokered private placement (the "Private Placement") was completed for 5,900,000 Class A shares at a price of $0.25 per share to the new directors, officers, employees and certain of their associates and affiliates.

In accordance with the policies of the TSXV, the 5,900,000 Class A shares which were issued pursuant to the Private Placement were placed in escrow. Under the terms of the Escrow Agreement, ten percent (10%) of such Class A shares were released from escrow upon receipt of notice from the TSXV confirming the listing of the Class A shares on the TSXV (the "Listing Notice"), which was dated on May 22, 2007. The remaining ninety percent (90%) of such Class A shares are to be released from escrow in fifteen percent (15%) tranches during consecutive six month intervals over the following 36 months, commencing on November 22, 2007. The above escrow release schedule is subject to acceleration in accordance with NP 46-201 Escrow for Initial Public Offerings and the policies of the TSXV in the event that the Company subsequently meets certain listing requirements.

On December 6, 2007, the Company completed a second private placement of 4,166,700 Class A shares at a price of $2.40 per share on a bought deal private placement basis for total gross proceeds of $10,000,080. The shares issued are subject to a four-month holding period. Share issue costs were $723,191.

As at December 31, 2007 and March 20, 2008, 15,282,700 Class A shares and 1,173,600 Class B shares were issued and outstanding. As at December 31, 2007 and March 20, 2008 no common voting, common non-voting or preferred shares were outstanding.

The Company has a stock option plan whereby options to purchase Class A shares may be granted by the board of directors to directors, officers, employees of, and consultants to the Company. The Plan has reserved for issuance a number of Class A shares equal to ten percent of the aggregate number of Class A shares and Class B shares issued and outstanding from time to time. As at December 31, 2007, no options were issued and outstanding.

On January 21, 2008, the Company granted 1,347,000 incentive stock options to purchase Class A shares to certain of its directors, officers, employees, and consultants. The options are exercisable over a five-year period at $3.97 per share with one-third vesting immediately, one-third vesting one year from date of grant, and one-third vesting two years from date of grant. At March 20, 2008 a total of 1,347,000 stock options were issued and outstanding.

On March 18, 2008, the Company announced a $20.8 million asset acquisition for producing assets and land located in northeast British Columbia. Consideration will be the issuance of 4,110,000 Class A shares at a deemed price of $4.33 per share and approximately $3.0 million cash, before closing adjustments and related costs. The acquisition is expected to close March 31, 2008, and is subject to certain conditions including normal regulatory approvals and approval of the TSX Venture Exchange.

INCOME TAXES

The Company has income tax pools as at December 31, 2007 of approximately $26.7 million including a tax loss carry forward of approximately $13.7 million. No tax asset for the value of these pools has been recorded for accounting purposes as the Company does not believe that it currently meets the criteria of the losses being utilized being more likely than not.

On May 17, 2007, the Company issued 12,000 units at $1,000 per unit for total proceeds of $12.0 million, on a flow-through basis, and has committed to spend these funds on qualified exploration and development expenditures by December 31, 2008. In February of 2008, the Company renounced the full $12.0 million effective December 31, 2007. The tax effect of the tax benefits renounced to subscribers will be recognized in the consolidated financial statements when the renouncement documents were filed in February, 2008. As at December 31, 2007, the Company had expended approximately $4,561,000 of funds on qualified expenditures related to this financing. The remaining commitment of $7,439,000 as at December 31, 2007 is to be incurred by December 31, 2008.

DIVIDENDS

The Company has not declared or paid any dividends. Any decision to pay dividends on its shares will be made by the board of directors on the basis of earnings, financial requirements and other conditions existing at such future time

COMPREHENSIVE INCOME

As Painted Pony does not have any comprehensive income, the consolidated financial statements do not include a statement of comprehensive income describing the components, nor is a section needed in shareholders' equity, nor is a statement of accumulated other comprehensive income presented (which would provide a continuity of the balance).

LIQUIDITY

As at December 31, 2007, Painted Pony had current assets of $20,489,683 and current liabilities of $4,238,890. The cash has been, and is currently, on deposit in term deposits in a major Canadian financial institution. Management has received confirmation from the financial institution that these funds are available on demand.

In 2007, the Company committed to spending $12.0 million on qualifying exploration and development expenditures prior to December 31, 2008 relating to a flow-through agreement, of which approximately $4,561,000 has been expended as at December 31, 2007.

Management believes the Company has sufficient financial resources with which to carry out the committed capital expenditures.

FOURTH QUARTER

Funds flow from operations during the fourth quarter of 2007 was $575,864, an increase of 621% over the third quarter funds flow from operations of $79,885. In the last quarter of 2007, the Company recorded net earnings of $164,855, primarily as a result of the incremental crude oil sales and interest income, compared to net earnings of $46,254 recorded in the third quarter of 2007.

Sales volumes for the three months ended December 31, 2007 were 8,648 barrels (94 bbl/d) of light crude oil, up from the 513 barrels (6 bbl/d) of crude oil produced during the third quarter of 2007. During the fourth quarter, two additional light crude oil wells were placed on production; a vertical well producing from the Midale zone in the Alameda area and a horizontal well producing from the Bakken zone in the Midale area. The Company initiated drilling of three horizontal Bakken wells during the fourth quarter of 2007, all of which are on production as of this date.

During the fourth quarter of 2007, pre-transportation revenue of $744,092 was 1,820% higher than third quarter 2007 pre-transportation revenue. For the three months ending December 31, 2007, Painted Pony received an average crude oil price of $86.06 before transportation costs, 14% higher than the average price received during the third quarter. The Edmonton par reference price for light oil during the fourth quarter of 2007 was $87.18.

In the fourth quarter of 2007, the Company paid $108,153 in royalties, compared to $4,132 paid during the third quarter of 2007. As a percentage of sales, royalties were 14.5% during the fourth quarter of 2007, compared to 11% in the third quarter of 2007 due to commencement of production from higher productivity wells and additional freehold production. Freehold royalty rates are higher than crown rates due to the Saskatchewan royalty incentive program. In the fourth quarter of 2007, operating costs totalled $53,941 ($6.24/bbl), compared to third quarter operating costs of $4,668 ($9.10/bbl). Per unit costs have declined as production volumes have increased and economies of scale begin to be realized. During the fourth quarter of 2007, company field operating netbacks improved 13% to $62.49 per bbl, compared to $55.09 per bbl during the third quarter of 2007, primarily as a result of higher crude oil prices and lower per unit operating costs.

In the fourth quarter of 2007, the net costs of general and administrative charges were $144,528, compared to $102,369 in the third quarter of 2007, as recoveries are recognized through allocation of costs to capital projects.

During the fourth quarter of 2007, Painted Pony invested $2.5 million on capital projects, compared to $3.0 million invested during the third quarter of 2007.

Depletion, depreciation, and accretion expense for the fourth quarter of 2007 was $411,009, compared to $33,631 in the third quarter of 2007, reflecting the higher production level and incremental capital costs incurred as the Company continues to earn land under the terms of the initial two farm-in agreements.

SUBSEQUENT EVENTS

The Company has executed a new farm-in agreement in the first quarter of 2008. In 2008, pursuant to a farm-in arrangement with an industry competitor, the Company has committed to drill two (1.3 net) wells in Saskatchewan at an estimated net cost to Painted Pony of $1.95 million. The farm-in agreement is subject to a non-performance penalty of $0.5 million per well.

In March 2008, the Company entered into an agreement to acquire certain natural gas properties in northeast British Columbia ("the Assets"). The consideration for the acquisition consists of 4,110,000 Class A common shares of Painted Pony issued at $4.33 per share and approximately $3.0 million cash, for a total purchase price of $20.8 million, before closing adjustments and related costs. The shares are subject to certain terms, restrictions and conditions until March 31, 2009. The acquisition has an expected closing date of March 31, 2008. The completion of the acquisition is subject to certain conditions including normal regulatory approvals, including approval of the TSX Venture Exchange.

OUTLOOK

The Company continues evaluation of its existing and farm-in lands for multi-zone light oil potential. During the first quarter of 2008, the Company has drilled 11 (3.74 net) successful horizontal Bakken wells for light sweet oil. Painted Pony drilled seven (1.84 net) in the Kisbey area and had placed six (1.58 net) of the wells on production prior to the end of the first quarter of 2008. In the Midale area, the Company drilled four gross (1.9 net revenue interest) wells and placed 2 (1.0 net revenue interest) on production prior to March 31, 2008.

As Painted Pony's operations are focused within Saskatchewan and British Columbia, the Company will not be directly affected by the recently announced amendments to royalty rates for assets located within Alberta.

Currently the Company receives a crude oil price of approximately 2% less than the Edmonton light reference price. As exploration is extended onto new Bakken trends in 2008, this discount may change depending on the quality of the oil found. Management anticipates future royalty rates to approximate the fourth quarter rate as drilling continues on a combination of freehold and crown royalty lands combined with gross overriding royalty obligations, reduced by the Saskatchewan royalty incentive programs for crown royalties and freehold mineral tax obligations. In 2008, the Company is planning to construct a crude oil central battery and gathering system in the Kisbey area, which is anticipated to reduce trucking and operating costs for crude oil.

Operating costs are anticipated to reflect the normal incremental costs inherent to production operations during periods of extreme cold over the winter season, as operational issues such as freezing pipes are accommodated. Similarly, during spring breakup, potential temporary production disruptions may occur due to an inability to access locations to truck product or conduct maintenance procedures.

Painted Pony's 2008 capital expenditures will be determined on an on-going basis, as consideration is given to expected cash flows, the availability of credit facilities and investment capital. It is the intention of the Company's management to maintain a maximum net debt to historical cash flow ratio of 1.0 : 1.0. The capital program will be adjusted accordingly. The Company plans an active drilling program of up to 40 Bakken horizontal wells during the last three quarters of 2008. Capital activity on the BC assets that the Company is in the process of purchasing will be determined in conjunction with discussions with various industry partners.

OFF BALANCE SHEET ARRANGEMENTS

The Company also entered into an arrangement with a joint venture partner whereby Painted Pony was carried for approximately $241,627 of land costs incurred by the joint venture partner in exchange for an equivalent value in the drilling of wells by the Company in 2008. This obligation was satisfied during the first quarter of 2008.

RELATED PARTY TRANSACTIONS

The Company utilizes the services of a law firm in which the Corporate Secretary is a Partner. During the period ended December 31, 2007, the Company incurred $186,834 on services obtained from the firm.

For the period ended December 31, 2007, a family member of the President provided computer consulting services entered into on normal commercial terms for $2,302.

All related party transactions are in the normal course of business and have been measured at the agreed to terms and exchange values, being the consideration established and agreed to by the parties and on normal commercial terms comparable to those negotiated with third parties.

FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

The fair values of the Company's term deposits, accounts receivables, accounts payables and accrued liabilities approximate their carrying amounts due to the short-tem nature of these financial instruments.

The Company's accounts receivables are primarily with industry partners and are subject to normal industry credit risks. As the Company extends unsecured credit to these entities, therefore, the collection of any receivables may be affected by changes in the economic environment or other conditions. Management believes the risk is mitigated by the financial position of the entities, and the Company's practice of requesting cash call advances for funds estimated to be incurred.

To date, the Company has not participated in any hedges or commodity price contracts.

FINANCIAL REPORTING UPDATE

Capital disclosures

The CICA issued a new accounting standard, "Capital Disclosures", which requires the disclosure of both qualitative and quantitative information that provides users of financial statements with information to evaluate the entity's objective, policies, and processes for managing capital. This new section is effective for the Company beginning January 1, 2008.

Financial instruments

Two new accounting standards were issued by the CICA, "Financial Instruments Disclosures", and "Financial Instruments Presentation". These sections will replace "Financial Instruments Disclosure and Presentation", once adopted. The objective is to provide users with information to evaluate the significance of instruments, and how the entity manages those risks. The provisions deal with the classification of financial instruments, related interest, dividends, losses and gains, and the circumstances in which financial assets and financial liabilities are offset. These new sections are effective for the Company beginning January 1, 2008.

International financial reporting standards ("IFRS")

In September 2007, the Accounting Standards Board ("AcSB") issued a bulletin relating to the transition to IFRS from Canadian GAAP and based on work undertaken to date, no significant impediments to adopting IFRS by the proposed transition date have been identified. Painted Pony is monitoring industry discussion regarding the replacement of the CICA's Accounting Guideline 16 with IFRS 6, which is expected to have material implications for Painted Pony's current full cost accounting policies. In February 2008, the AcSB confirmed the transition date for adopting IFRS will be January 1, 2011.

BUSINESS RISKS, UNCERTAINTIES AND FORWARD LOOKING STATEMENTS

Statements in this document may contain forward-looking information including expectations of future production, components of cash flow and earnings, expected future events and/or financial results that are forward looking in nature and subject to substantial risks and uncertainties. The reader is cautioned that assumptions used in the preparation of such information may prove to be incorrect. The Company cautions the readers that actual performance will be affected by a number of factors, as many may respond to changes in economic and political circumstances throughout the world. Events or circumstances may cause actual results to differ materially from those predicted, a result of numerous known and unknown risks, uncertainties, and other factors, many of which are beyond the control of the Company. These risks include, but are not limited to; the risks associated with the oil and gas industry, commodity prices and exchange rate changes. Industry related risks could include, but are not limited to; operational risks in exploration, development and production, delays or changes in plans, risks associated with the uncertainty of reserve estimates, health and safety risks and the uncertainty of estimates and projections of production, costs and expenses. These external factors beyond the Company's control may affect the marketability of oil and natural gas produced, industry conditions including changes in laws and regulations, changes in income tax regulations, increased competition, fluctuations in commodity prices, interest rates, and variations in the Canadian/United States dollar exchange rate. The reader is cautioned not to place undue reliance on this forward looking information.

Painted Pony's production and exploration activities are concentrated in the Western Canadian Sedimentary Basin, where activity is highly competitive and includes a variety of different sized companies ranging from smaller junior producers to the much larger integrated petroleum companies. Painted Pony is subject to the various types of business risks and uncertainties including:

- *Finding and developing oil and natural gas reserves at economic costs;*
- *Production of oil and natural gas in commercial quantities; and*
- *Marketability of oil and natural gas produced.*

In order to reduce exploration risk, the Company strives to employ highly qualified and motivated professional employees with a demonstrated ability to generate quality proprietary geological and geophysical prospects. To help maximize drilling success, Painted Pony combines exploration in areas that afford multi-zone prospect potential, targeting a range of low to moderate risk prospects with some exposure to select high-risk plays with high-reward opportunities. Painted Pony also explores in areas where the Company's officers and employees have significant drilling experience.

The Company mitigates its risk related to producing hydrocarbons through the utilization of the most appropriate technology and information systems. In addition, Painted Pony seeks to maintain operational control of the majority of its prospects.

Oil and gas exploration and production can involve environmental risks such as pollution of the environment and destruction of natural habitat, as well as safety risks such as personal injury. In order to mitigate such risks, Painted Pony conducts its operations at high standards and follows safety procedures intended to reduce the potential for personal injury to employees, contractors and the public at large. The Company maintains current insurance coverage for general and comprehensive liability as well as limited pollution liability. The amount and terms of this insurance are reviewed on an ongoing basis and adjusted as necessary to reflect changing corporate requirements, as well as industry standards and government regulations. Painted Pony may periodically use financial or physical delivery hedges to reduce its exposure against the potential adverse impact of commodity price volatility, as governed by formal policies approved by senior management, subject to controls established by the Board of Directors.

CRITICAL ACCOUNTING ESTIMATES

The reader is cautioned that the preparation of financial statements in accordance with GAAP requires management to make certain judgments and estimates that affect the reported amounts of assets, liabilities, revenues and expenses. Estimating reserves is also critical to several accounting estimates and requires judgments and decisions based upon available geological, geophysical, engineering and economic data. Estimated reserves are also utilized by Painted Pony's bank in determining credit facilities. Reserves affect net income through depletion, site restoration and abandonment estimates and the ceiling test calculation. Estimating reserves is very complex, requiring many judgments based on available geological, geophysical, engineering and economic data. Changes in these judgments could have a material impact on the estimated reserves. These estimates may change, having either a negative or positive effect on net earnings as further information becomes available, and as the economic environment changes. Changes in these judgments and estimates could have a material impact on the financial results and financial condition of the Company. The "Management's Discussion and Analysis" outlines the accounting policies and practices that are critical to determining Painted Pony's financial results.

In following the liability method of accounting for income taxes, related assets and liabilities are recognized for the estimated tax consequences between amounts included in the financial statements and their tax base, using substantively enacted future income tax rates. Timing of future revenue streams and future capital spending changes can affect the timing of any temporary differences, and accordingly affect the amount of the future income tax liability calculated at a point in time. These differences could materially impact earnings.

With the above risks and uncertainties, the reader is cautioned that future events and results may vary substantially from that which the Company currently foresees.

LEGAL, ENVIRONMENTAL, REMEDIATION AND OTHER CONTINGENT MATTERS

The Company reviews legal, environmental, remediation and other contingent matters to both determine whether a loss is probable based on judgment and interpretation of laws and regulations, and determine that the loss can reasonably be estimated. When the loss is determined, it is charged to earnings. The Company's management monitor known and potential contingent matters and make appropriate provisions by charges to earnings when warranted by circumstances.

INTERNAL CONTROLS

As of December 31, 2007 the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO") have evaluated the design and effectiveness of the Company's disclosure controls and procedures. The small size of the current organization contributes in a large part to senior management being fundamentally aware of material information that would require disclosure by the Company and this, in part, supports management's assessment that its disclosure controls are adequate and effective to ensure accurate and complete disclosure, except as described below.

The Chief Executive Officer and Chief Financial Officer of Painted Pony are responsible for designing internal controls over financial reporting, or causing them to be designed under their supervision, in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with Canadian generally accepted accounting principles. Painted Pony management has assessed the design of internal controls over financial reporting. During this process, certain material weaknesses in internal controls over financial reporting were identified as follows:

- *Due to the limited number of staff at Painted Pony, it is not economically feasible to achieve segregation of incompatible duties. Painted Pony currently, as of December 31, 2007, had seven full time and two part-time employees. The limited number of staff may also result in identifying weaknesses with respect to accounting for complex and non-routine accounting transactions that may arise as the Company does not have a sufficient number of finance personnel with technical accounting knowledge to address all complex and non-routine accounting matters that may arise, and*

- *Many of Painted Pony's information systems are subject to general control deficiencies including a lack of effective controls over spreadsheets, access and documentation.*

These weaknesses in internal controls over financial reporting result in a more than remote likelihood that a material misstatement would not be prevented or detected. Management and the Board of Directors try to mitigate the risk of material misstatement; however, reasonable assurance does not exist that this risk can be reduced to a remote likelihood of a material misstatement. Painted Pony has no current plans to remediate these weaknesses.

Because of their inherent limitations, disclosure controls as well as internal controls over financial reporting may not prevent or detect fraud, misstatements, or errors. Control systems can provide only reasonable and not absolute assurance that the objectives of the control system and the Company are achieved.

SELECTED CONSOLIDATED QUARTERLY INFORMATION

Painted Pony commenced commercial operations on April 3, 2007 upon completion of a financial reorganization as part of an overall restructuring of the Company. Pursuant to "Comprehensive Revaluation of Assets and Liabilities" of the CICA Handbook, the Company is entitled to use "fresh start" accounting which means that prior or comparative financial information is not required to be presented as it would not be meaningful to the reader. Accordingly, financial information is presented commencing on April 3, 2007. Consequently, comparative financial information for the balance sheet, statements of operations and cash flows is not presented.

The following table sets forth selected consolidated financial information of the Corporation for the most recently completed quarters ending at the fourth quarter of 2007.

SELECTED CONSOLIDATED QUARTERLY INFORMATION

2007 - Quarter ended *(unaudited) ($)*	**June 30**	**Sept 30**	**Dec 31**
Gross revenues [1]	64,322	192,746	924,194
Funds flow (used in) from operations	(52,793)	79,885	575,864
Funds flow (used in) from operations			
Basic and diluted, per share	(0.01)	0.00	0.04
Net earnings (loss)	(53,661)	46,254	164,855
Net earnings (loss) per share			
Basic and diluted	(0.01)	0.00	0.01
Capital expenditures, net	497,615	3,027,516	2,532,377
Total assets	13,865,033	17,054,020	26,194,023
Long-term financial liabilities (ARO)	5,081	26,954	92,340

(1) Before royalties and transportation, including interest and other income

The following table sets forth selected consolidated financial information of the Corporation for the most recently completed annual period ending at December 31, 2007.

SELECTED CONSOLIDATED ANNUAL INFORMATION

Period ended December 31, *($)*	**2007**
Gross revenues [1]	1,181,262
Funds flow from operations	602,956
Funds flow from operations per share	
Basic and diluted	0.07
Net income for the period	157,448
Net income per share	
Basic and diluted	0.02
Capital expenditures, net	6,057,508
Total assets	26,194,023
Long-term financial liabilities (ARO)	92,340

(1) Before royalties and transportation, including interest and other income

READER ADVISORY

Statements in this document may contain forward-looking information including expectations of future production and components of cash flow and earnings. The reader is cautioned that assumptions used in the preparation of such information may prove to be incorrect. Events or circumstances may cause actual results to differ materially from those predicted, a result of numerous known and unknown risks, uncertainties, and other factors, many of which are beyond the control of the Company. These risks include, but are not limited to; the risks associated with the oil and gas industry, commodity prices and exchange rate changes. Industry related risks could include, but are not limited to; operational risks in exploration, development and production, delays or changes in plans, risks associated with the uncertainty of reserve estimates, health and safety risks and the uncertainty of estimates and projections of production, costs and expenses. The reader is cautioned not to place undue reliance on this forward-looking information.

The reader is further cautioned that the preparation of consolidated financial statements in accordance with GAAP requires management to make certain judgments and estimates that affect the reported amounts of assets, liabilities, revenues and expenses. Estimating reserves is also critical to several accounting estimates and requires judgments and decisions based upon available geological, geophysical, engineering and economic data. These estimates may change, having either a negative or positive effect on net earnings as further information becomes available, and as the economic environment changes.

MANAGEMENT'S RESPONSIBILITY FOR CONSOLIDATED FINANCIAL STATEMENTS

The management of Painted Pony Petroleum Ltd. (the "Company") is responsible for the preparation and integrity of the accompanying consolidated financial statements and all other information contained in this report. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles ("GAAP") in Canada and include amounts that are based on management's informed judgments and estimates where necessary.

The Company has established internal accounting control systems which are designed to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of the consolidated financial statements together with the other financial information for external purposes in accordance with Canadian GAAP.

The Board of Directors, through its Audit Committee, monitors management's financial and accounting policies and practices and the preparation of these consolidated financial statements. The Audit Committee meets periodically with the external auditors and management to review the work of each and the propriety of the discharge of their responsibilities.

The Audit Committee reviews the consolidated financial statements of the Company with management and the external auditors prior to submission to the Board of Directors for final approval. The external auditors and the Board of Directors also review the consolidated financial statements before they are finalized. The external auditors have full and free access to the Audit Committee to discuss auditing and financial reporting matters. The Audit Committee reviews the independence of the external auditors and pre-approves audit and permitted non-audit services. The Shareholders have appointed KPMG LLP as the external auditors of the Company, and in that capacity, they have examined the consolidated financial statements for the period ended December 31, 2007.

Patrick R. Ward
President and CEO

Joan E. Dunne
Vice President, Finance and CFO

March 31, 2008

AUDITORS' REPORT

To the Shareholders of Painted Pony Petroleum Ltd.

We have audited the consolidated balance sheet of Painted Pony Petroleum Ltd. as at December 31, 2007 and the consolidated statements of operations and deficit and cash flows for the period ended December 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2007 and the results of its operations and its cash flows for the period ended December 31, 2007 in accordance with Canadian generally accepted accounting principles.

KPMG LLP

KPMG LLP
Chartered Accountants
Calgary, Canada

March 31, 2008

		As at December 31, 2007
ASSETS		
Current assets		
Cash and cash equivalents	$	17,349,245
Accounts receivable		3,075,578
Prepaid expenses and deposits		64,860
		20,489,683
Property and equipment *(note 5)*		5,704,340
	$	26,194,023
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	$	4,238,890
Asset retirement obligations *(note 7)*		92,340
		4,331,230
Shareholders' equity		
Capital stock *(notes 4 & 8)*		22,709,345
Deficit *(note 4)*		(846,552)
		21,862,793
	$	26,194,023

Basis of presentation *(notes 2 & 4)*

Commitments *(note 12)*

Subsequent events *(notes 6, 8, 12 & 14)*

See accompanying notes to the consolidated financial statements.

Approved on behalf of the Board:

Glenn R. Carley
Director

Patrick R. Ward
Director

CONSOLIDATED STATEMENT OF OPERATIONS AND DEFICIT

		Period ended December 31, 2007
Revenue		
Petroleum sales	$	782,843
Royalties		(112,285)
Interest income		350,227
Other income		48,192
		1,068,977
Expenses		
Operating		58,609
Transportation		43,400
General and administrative		364,012
Depletion, depreciation and accretion		445,508
		911,529
Net income for the period		157,448
Deficit, beginning of period *(note 4)*		(1,004,000)
Deficit, end of period	$	(846,552)
Net income per share *(note 9)*		
Basic and diluted	$	0.02

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

		Period ended December 31, 2007
Cash provided by (used in)		
Operating activities		
Net income for the period	$	157,448
Items not affecting cash:		
Depletion, depreciation, and accretion		445,508
		602,956
Change in non-cash working capital		(436,408)
		166,548
Financing activities		
Issuance of share capital		23,475,080
Share issuance costs		(1,769,736)
		21,705,344
Investing activities		
Expenditures on property and equipment		(6,057,508)
Change in non-cash working capital		1,534,861
		(4,522,647)
Increase in cash and cash equivalents		17,349,245
Cash and cash equivalents, beginning of period		-
Cash and cash equivalents, end of period	$	17,349,245
Cash and cash equivalents is comprised of:		
Balances with banks	$	49,245
Short term deposits		17,300,000
	$	17,349,245

See accompanying notes to the consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Period ended December 31, 2007

1. NATURE OF OPERATIONS

Painted Pony Petroleum Ltd.'s (the "Company") principal business activity is the exploration, development and production of petroleum and natural gas resources in western Canada.

2. BASIS OF PRESENTATION

The consolidated financial statements of Painted Pony Petroleum Ltd. have been prepared by management in accordance with Canadian generally accepted accounting principles. These consolidated financial statements include the accounts of Painted Pony Petroleum Ltd. and its wholly-owned subsidiary, Painted Pony Petroleum Corporation.

The Company commenced commercial operations on April 3, 2007 upon completion of the financial reorganization (see note 4). Consequently, comparative financial information for the statements of operations and cash flows is not presented.

3. SIGNIFICANT ACCOUNTING POLICIES

Use of estimates

The preparation of consolidated financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the balance sheet date and the reported amounts of revenue and expenses during the period. The consolidated financial statements have, in management's opinion, been properly prepared using careful judgment with reasonable limits of materiality and within the framework of the significant accounting policies summarized below. Actual results could differ from those estimates.

Property and equipment

(i) Capitalized costs
The Company follows the Canadian full cost method of accounting for its petroleum and natural gas operations. Under this method, all costs related to the exploration, development and production of petroleum and natural gas reserves are capitalized in a single Canadian cost centre. Costs include lease acquisition costs, geological and geophysical expenses, costs of drilling both productive and non-productive wells, production equipment costs, general and administrative costs and stock-based compensation directly related to exploration and development activities. Proceeds from the sale of properties are applied against capitalized costs, without any gain or loss being realized, unless such sale would alter the rate of depletion by more than 20%. Office equipment is recorded at cost.

(ii) Depletion and depreciation
Petroleum and natural gas properties, net of estimated salvage or residual value, and estimated costs of future development of proved undeveloped reserves are depleted and amortized using the unit-of-production method based on estimated gross proved petroleum and natural gas reserves as determined by independent engineers. For depletion and amortization purposes, relative volumes of petroleum and natural gas production and reserves are converted at the energy equivalent conversion rate of six thousand cubic feet of natural gas to one barrel of crude oil.

Costs of unproved properties and seismic costs on undeveloped land are initially excluded from petroleum and natural gas properties for the purpose of calculating depletion. When proved reserves are assigned, or the property or seismic is considered to be impaired, the costs of the property or seismic or the amount of the impairment is added to costs subject to depletion.

Office equipment is depreciated over its estimated useful life at a declining-balance rate of 20%.

(iii) Ceiling test

In applying the full cost method, the Company calculates a ceiling test whereby the carrying amount of property and equipment is compared to the sum of the undiscounted cash flows expected to result from the future production of proved reserves and the sale of unproved properties. Cash flows are based on third party quoted forward prices, adjusted for transportation and quality differentials. Should the ceiling test result in an excess of carrying amount, the Company would then measure the amount of impairment by comparing the carrying amounts of property and equipment to an amount equal to the estimated net present value of future cash flows from proved plus probable reserves and the sale of unproved properties. The Company's risk-free interest rate is used to arrive at the net present value of the future cash flows. Any excess carrying amount would be recorded as a permanent impairment.

Asset retirement obligations

The Company recognizes the fair value of an Asset Retirement Obligation ("ARO") in the period in which it is incurred when a reasonable estimate of the fair value can be made. The fair value is determined through a review of engineering studies, industry guidelines and management's estimate on a site-by-site basis. The fair value of the estimated ARO is recorded as a liability, with a corresponding increase in the carrying amount of the related asset. The capitalized amount is depleted on the unit-of-production method based on gross proved reserves. The liability amount is increased each reporting period to reflect the passage of time with the corresponding amount charged to earnings as accretion expense. Actual costs incurred upon the settlement of the asset retirement obligation are charged against the asset retirement obligations to the extent of the liability recorded.

Joint operations

Substantially all of the exploration and production activities of the Company are conducted jointly with others and these consolidated financial statements reflect only the Company's proportionate interest in such activities.

Income taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of assets and liabilities and their respective tax basis. Future tax assets and liabilities are measured using substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. A valuation allowance is recorded against any future income tax assets if it is more likely than not that the asset will not be realized. The effect on future tax assets and liabilities of a change in tax rates is recognized in earnings in the period that includes the date of substantive enactment.

Period ended December 31, 2007

Flow-through shares

Periodically, the Company may finance a portion of its exploration and development activities through the issuance of flow-through shares. Under the terms of the flow-through share issues, the tax attributes of the related expenditures are renounced to subscribers. Share capital is reduced and future tax liability is increased by the tax effected amount of the renounced tax deductions at the time of renouncement, which is when the related documentation is filed with the appropriate governmental agency and there is reasonable certainty that the expenditures will be incurred.

Stock-based compensation

The Company accounts for stock option agreements using the fair value method. Under this method, the fair value of the stock options, measured at the grant date, is charged to operations over the vesting period, with a corresponding increase in contributed surplus. Upon exercise of the stock options, consideration paid by the option holder, together with the amount recognized in contributed surplus, is credited to share capital.

Revenue recognition

Revenue from the sale of crude oil, natural gas and natural gas liquids are recognized based on volume delivered at contractual delivery points and rates. The cost associated with the delivery, including operating, transportation and production-based royalty expenses are recognized in the same period in which the related revenue is earned and recorded.

Per share amounts

Basic earnings per share is computed by dividing net income by the weighted average number of Class A and Class B common shares outstanding during the period. The treasury stock method is used to calculate diluted per share amounts whereby proceeds from the exercise of in-the-money stock options and unrecognized future stock-based compensation expense are assumed to be used to purchase common shares of the Company at the average market price during the period. Diluted per share amounts reflect the potential dilution that could occur if stock options to purchase common shares were exercised and converted to common shares. In addition, Class B shares are converted into Class A shares at $10 divided by the greater of $1.00 and the current market price, defined as the weighted average trading price per share of the Class A shares for the last 30 consecutive trading days.

Cash and cash equivalents

The Company considers all highly liquid investments with a maturity of three months or less at the time of purchase to be cash equivalents. These cash equivalents primarily consist of funds on deposit under various terms.

Measurement uncertainty

The amounts recorded for depletion and depreciation of petroleum and natural gas properties and the ceiling test calculation are based on estimates of gross proved reserves, production rates, commodity prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effects on the consolidated financial statements of changes in such estimates in future years could be significant.

The value of the asset retirement obligations was based on the Company's net ownership interests in all wells and facilities, and depends on estimates of current market interest rates, inflation rates, and future restoration and reclamation expenditures. By their nature, these estimates are subject to measurement uncertainty and the effect of changes of estimates on the consolidated financial statements in future periods could be significant.

The calculation of future income tax is based on assumptions, which are subject to uncertainty as to timing as well as the tax rates at which temporary differences are expected to reverse.

The Black-Scholes option valuation model was developed for use in estimating the fair value of options, which were fully tradable with no vesting restrictions. This option valuation model requires the input of assumptions including the expected stock price volatility. Because the Company's stock options have characteristics significantly different from those of traded options and because changes in the input assumptions can materially affect the calculated fair value, such value is subject to measurement uncertainty.

Change in accounting policies

As of January 1, 2007, the Company adopted new accounting standards for "Accounting Changes", "Comprehensive Income", "Equity", "Financial Instruments - Recognition and Measurement", "Financial Instruments - Disclosure and Presentation" and "Hedges".

Accounting changes provides expanded disclosures for changes in accounting policies, accounting estimates and corrections of errors. Under the new standard, accounting changes should be applied retrospectively unless otherwise permitted or where impracticable to determine. As well, voluntary changes in accounting policy are made only when required by a primary source of GAAP or the change results in more relevant and reliable information.

Comprehensive income introduces a new requirement to temporarily present certain gains and losses from changes in fair value outside net income. It includes unrealized gains and losses, such as changes in currency translation adjustment relating to self-sustaining foreign operations, unrealized gains or losses on available-for-sale investments and the effective portion of gains or losses on derivatives designated as cash flow hedges. The application of this revised standard did not result in comprehensive income being different from the net income for the period presented.

Financial instruments - recognition and measurement prescribes when a financial instrument is to be recognized on the balance sheet and at what amount. It also specifies how financial instrument gains and losses are to be presented. All financial instruments are classified into one of the following five categories: held-for-trading (cash and cash equivalents), held-to-maturity (none), loans and receivables (accounts receivable), available-for-sale financial assets (none), and other financial liabilities (accounts payable). Initial and subsequent measurement and recognition of changes in the value of financial instruments depends on their initial classification.

- *Held-to-maturity investments, loans and receivables, and other financial liabilities are initially measured at fair value and subsequently measured at amortized cost. Amortization of premiums or discounts and losses due to impairment are included in current period net income.*

- *Available-for-sale financial assets are measured at fair value. Revaluation gains and losses are included in other comprehensive income until the asset is removed from the balance sheet.*

- *Held for trading financial instruments are measured at fair value. All gains and losses are included in the net income in the period in which they arise.*

- *All derivative financial instruments are classified as held-for-trading financial instruments and are measured at fair value, even when they are part of a hedging relationship. All gains and losses are included in net income in the period which they arise.*

The application of these new standards did not have an impact on the Company's consolidated financial statements.

Hedges provide alternative treatments for entities that choose to designate qualifying transactions as hedges for accounting purposes.

Future changes in accounting policies

The CICA issued a new accounting standard, "Capital Disclosures", which requires the disclosure of both qualitative and quantitative information that provides users of financial statements with information to evaluate the entity's objective, policies, and processes for managing capital. This new section is effective for the Company beginning January 1, 2008.

Two new accounting standards were issued by the CICA, "Financial Instruments Disclosures", and "Financial Instruments Presentation". These sections will replace "Financial Instruments Disclosure and Presentation" once adopted. The objective is to provide users with information to evaluate the significance of instruments, and how the entity manages those risks. The provisions deal with the classification of financial instruments, related interest, dividends, losses and gains, and the circumstances in which financial assets and financial liabilities are offset. These new sections are effective for the Company beginning January 1, 2008.

4. FINANCIAL REORGANIZATION

Effective March 20, 2007, the Company's debt and equity holders approved a financial reorganization, as part of an overall restructuring of the Company.

The Company's assets and liabilities have been adjusted to reflect the values established during the financial reorganization. The contributed surplus and the original share capital have been reclassified to deficit, and the Company commenced operations as of the date after the financial reorganization.

The effect of the financial reorganization on the balance sheet accounts is as follows:

	March 20, 2007 prior to financial reorganization	Reorganization adjustments	March 20, 2007 after financial reorganization
ASSETS	$ -	$ -	$ -
LIABILITIES AND SHAREHOLDERS' EQUITY			
Due to StoneBridge Merchant Capital Corp.	550,909	68,091 [(a)]	619,000
Convertible debentures	347,500	-	347,500
Common shares	42,500	(5,000) [(b)]	37,500
Contributed surplus	15,690,266	(15,690,266) [(c)]	-
Deficit	(16,631,175)	15,627,175 [(c)]	(1,004,000)
	$ -	$ -	$ -

(a) To reflect the agreed upon fair value of the debt.
(b) To eliminate share capital attributable to previously issued common shares.
(c) Reclassification of contributed surplus to deficit to reflect fresh start accounting as of the date of the financial reorganization.

On April 3, 2007, the Company:

- *changed its name from 1300873 Alberta Ltd. to Painted Pony Petroleum Ltd.;*
- *authorized an unlimited number of Class A shares;*
- *authorized an unlimited number of Class B shares convertible at the option of the Company at anytime after June 30, 2010 and before June 30, 2012, and convertible at the option of the holder after July 1, 2012 and before August 1, 2012, into Class A shares. Any outstanding Class B shares at August 1, 2012 shall be automatically converted into Class A shares;*
- *authorized an unlimited number of common voting shares;*
- *authorized an unlimited number of common non-voting shares, redeemable at the option of the holder;*
- *authorized an unlimited number of preferred shares issuable in series from time to time to be determined by the directors; and*
- *changed the 196 issued and outstanding common voting shares into:*
  - *(i) 29,400 issued and outstanding Class A shares on the basis of 150 Class A shares for each existing common voting shares, and*
  - *(ii) 6,615 issued and outstanding Class B shares on the basis of 33.75 Class B shares for each existing common voting share.*

5. PROPERTY AND EQUIPMENT

December 31, 2007	Cost	Accumulated depletion and depreciation	Net book value
Petroleum properties, including exploration and development thereon	$ 6,069,101	$ 435,473	$ 5,633,628
Other	78,295	7,583	70,712
	$ 6,147,396	$ 443,056	$ 5,704,340

For the period ending December 31, 2007, the Company capitalized general and administrative expenses in the amount of $399,107, relating to exploration and development activities. The Company has included $3,823,200 for future development costs and excluded $nil for undeveloped land and salvage values from the depletion calculation during the period ended December 31, 2007.

The Company performed a ceiling test calculation at December 31, 2007 and determined there was no impairment of its petroleum properties. The future prices used in the ceiling test calculation are based on a benchmark commodity price forecast used by the Company's independent reserve evaluators as follows:

	WTI crude oil *(US$/bbl)*	Edmonton light oil *(C$/bbl)*	US/CAN exchange rate *(US$/CAN$)*
2008	90.00	89.00	1.00
2009	86.70	85.70	1.00
2010	83.20	82.20	1.00
2011	79.60	78.50	1.00
2012	78.50	77.40	1.00
2013	77.30	76.20	1.00
2014	78.80	77.70	1.00
2015	80.40	79.30	1.00
2016	82.00	80.80	1.00
2017	83.70	82.50	1.00
2018	85.30	84.10	1.00
2019	87.00	85.80	1.00
2020	88.80	87.50	1.00
2021	90.60	89.30	1.00
2022	92.40	91.10	1.00
Thereafter	+ 2%/yr	+ 2%/yr	1.00

Adjustments were made to the benchmark prices for purposes of the ceiling test to reflect varied delivery points and quality differentials in the products delivered.

6. BANK DEBT

At December 31, 2007, Painted Pony had no bank debt. Subsequent to year end, Painted Pony secured a $7.5 million demand revolving credit facility and a $5 million demand non-revolving acquisition/development facility with a Canadian chartered bank. Interest is payable at the lender's prime rate plus one quarter percent (0.25%) on the demand revolving facility and at the lender's prime rate plus one half percent (0.50%) on the demand non-revolving facility. Security is provided by a first fixed and floating charge demand debenture of $50 million. Painted Pony has provided a negative pledge and undertaking to provide fixed charges over major petroleum and natural gas reserves in certain circumstances.

A standby fee is charged on one eighth of one percent (0.125%) on the undrawn portion of the credit facilities.

The availability under the demand revolving credit facility is restricted to $4,000,000 pending close of an asset acquisition, and the facilities are subject to an interim review date of May 31, 2008 and an annual review on or before May 31, 2009.

7. ASSET RETIREMENT OBLIGATIONS

The total future asset retirement obligations were estimated by management based on the Company's net ownership in wells and facilities, estimated costs to reclaim and abandon the wells and facilities, and the estimated timing of the costs to be incurred in future periods. The Company has estimated the total undiscounted asset retirement obligations to be $226,000 as at December 31, 2007. These payments are expected to be made over the next 20 years, with the majority estimated to be spent between 2026 and 2027. The Company used a credit adjusted risk free rate of 8% and an inflation rate of 2% to calculate the present value of the asset retirement obligations.

The following table reconciles the Company's asset retirement obligations:

		Period ended December 31, 2007
Obligation, beginning of period	$	-
Liabilities incurred		89,888
Accretion expensed		2,452
Obligation, end of period	$	92,340

8. CAPITAL STOCK

a) Authorized

Unlimited	Common voting shares, of which none are outstanding as at December 31, 2007
Unlimited	Common non-voting shares, of which none are outstanding as at December 31, 2007
Unlimited	Class A shares
Unlimited	Class B shares
Unlimited	Preferred shares, of which none are outstanding as at December 31, 2007

The Class A shares and the Class B shares are voting on the basis of one vote per share. There are no fixed dividends payable on either the Class A shares or the Class B shares. In the event of the liquidation or dissolution of the Company, the Class B shares will be converted at the conversion rate (further discussed under "Class B shares") into Class A shares and the Class A shares are entitled to receive, on a pro rata basis with the common voting and common non-voting shares, all assets of the Company as are distributable to the holders of shares.

The Class B Shares will be convertible, at the option of the Company, at any time after June 30, 2010 and on or before June 30, 2012 into Class A shares. The number of Class A shares obtained upon conversion of each Class B share will be equal to $10.00 divided by the greater of $1.00 and the current market price of the Class A shares.

If the conversion has not occurred by the close of business on June 30, 2012, the Class B shares become convertible, at the option of the shareholder, into Class A shares on the same basis. Any Class B shares outstanding at the close of business on August 1, 2012 shall be automatically converted into Class A shares on the same basis.

Period ended December 31, 2007

b) Issued and outstanding

Common voting shares

	Period ended December 31, 2007		
	Number of shares		Amount
Balance, beginning of period	100	$	5,000
Shares issued	96		37,500
Financial reorganization	-		(5,000)
April 3, 2007 prior to financial reorganization	196		37,500
Exchange into Class A and Class B shares	(196)		(37,500)
Balance, after financial reorganization	-	$	-

Class A and Class B shares

	Class A shares		Class B shares	
	Number of shares	Amount	Number of shares	Amount
Common voting shares exchanged into Class A and Class B shares pursuant to the financial reorganization	29,400	$ 3,750	6,615	$ 33,750
Flow-through shares issued	4,800,000	1,200,000	1,080,000	10,800,000
Shares issued in satisfaction of debt	386,600	96,650	86,985	869,850
Private placement to founders	5,900,000	1,475,000	-	-
Private placement	4,166,700	10,000,080	-	-
	15,282,700	12,775,480	1,173,600	11,703,600
Share issuance costs, allocated	-	(827,845)	-	(941,890)
Balance, December 31, 2007	15,282,700	$ 11,947,635	1,173,600	$ 10,761,710

On January 31, 2007, 96 common shares were issued for cash consideration of $37,500 pursuant to a private placement.

On February 2, 2007, by Articles of Amendment, the Company created an unlimited number of non-voting common shares and consolidated the issued common shares on the basis that up to 2,500 of such shares shall become one common share. All share and per share amounts have been retroactively adjusted to reflect this share consolidation.

Effective April 3, 2007 pursuant to the financial reorganization, the 196 issued and outstanding common voting shares were exchanged for:

(i) 29,400 issued and outstanding Class A shares on the basis of 150 Class A shares for each existing common voting shares, and

(ii) 6,615 issued and outstanding Class B shares on the basis of 33.75 Class B shares for each existing common voting share.

On May 17, 2007, the Company issued 12,000 units at a price of $1,000 per unit for gross proceeds of $12,000,000 (the "Offering"). Each unit is comprised of 400 Class A shares and 90 Class B shares issued on a "flow-through" basis. The Company is committed to spend these funds on qualified exploration and development expenditures by December 31, 2008. In February 2008, the Company renounced the full $12,000,000 effective December 31, 2007. The tax effect of the tax benefits renounced to subscribers will be recognized in the consolidated financial statements in February 2008 when the renouncement documents were filed. As at December 31, 2007, the Company had expended approximately $4,561,000 of funds on qualified expenditures related to this financing.

Subsequent to the closing of the Offering, the Company issued 386,600 Class A shares and 86,985 Class B shares in satisfaction of the convertible debenture in the amount of $347,500 and other debt in the amount of $619,000 (the "Debt Satisfaction").

Immediately after the closing of both the Offering and the Debt Satisfaction, a non-brokered private placement (the "Private Placement") was completed of 5,900,000 Class A shares at a price of $0.25 per share to the new directors, officers, employees and certain of their associates and affiliates. The 5,900,000 Class A shares are subject to escrow agreements whereby 10% were released from escrow on May 22, 2007, with the remaining 90% of such Class A shares released from escrow in 15% tranches during consecutive six month intervals over a 36 month period, commencing on November 22, 2007 and subject to acceleration in certain circumstances.

On December 6, 2007, the Company completed a bought deal private placement of 4,166,700 Class A shares at a price of $2.40 per share for gross proceeds of $10,000,080.

c) Stock option plan

The Company has a stock option plan (the "Plan") pursuant to which options to purchase Class A shares may be granted by the board of directors to directors, officers, employees of, and consultants to the Company. The Plan has reserved for issuance a number of Class A shares equal to 10% of the aggregate number of Class A shares and Class B shares issued and outstanding from time to time.

As at December 31, 2007, no options are issued and outstanding.

On January 21, 2008, the Company granted 1,347,000 incentive stock options to purchase Class A shares to certain of its directors, officers, employees, and consultants. The options are exercisable over a five-year period at $3.97 per share with one-third vesting immediately, one-third vesting one year from date of grant, and one-third vesting two years from date of grant.

9. PER SHARE AMOUNTS

The weighted average number of Class A shares outstanding during the period ended December 31, 2007 was 7,280,725. The weighted average number of Class B shares outstanding during the period ended December 31, 2007 was 738,512. The weighted average number of Class A shares outstanding after deemed conversion of the Class B shares was 9,262,083, for the period ending December 31, 2007.

10. INCOME TAX

The provision for income tax differs from that which would be obtained from applying the combined Canadian federal and provincial income tax rate to net income before income tax. The difference results from the following:

		Period ended December 31, 2007
Net income for the period	$	157,448
Combined corporate tax rate		35.62%
Computed "expected" income tax expense		56,083
Non-deductible expenses		5,104
Change in valuation allowance		(654,999)
Change in tax rates		588,938
Other		4,874
Income tax expense	$	-

The components of the Company's future income tax asset are as follows:

		As at December 31, 2007
Non-capital losses	$	4,352,500
Property and equipment		1,650,781
Share issue costs		430,046
Asset retirement obligations		24,932
		6,458,259
Less: valuation allowance		(6,458,259)
	$	-

At December 31, 2007, the Company had a non-capital loss of approximately $13.7 million, expiring in varied amounts over the next 19 years, which may be applied to reduce future years' taxable income.

11. RELATED PARTY TRANSACTIONS

The Company utilizes the services of a law firm in which the Corporate Secretary is a Partner. During the period ended December 31, 2007, the Company incurred $186,834 on services obtained from the firm.

For the period ended December 31, 2007, a family member of the President provided computer consulting services entered into on normal commercial terms for $2,302.

All related party transactions are in the normal course of business and have been valued at the agreed to terms and exchange values, being the consideration established and agreed to by the parties and on normal commercial terms comparable to those negotiated with third parties.

12. COMMITMENTS

The Company is committed to spending $12,000,000 on qualifying exploration and development expenditures prior to December 31, 2008 relating to a flow-through agreement, of which $4,561,000 has been expended as at December 31, 2007.

The Company executed a farm-in agreement whereby the Company has committed to drill four (2.4 net capital interest) wells on the land at an estimated net cost of $3.78 million.

The Company executed a new farm-in agreement in the first quarter of 2008. Under the terms of the agreement, Painted Pony will pay a gross overriding royalty and has committed to drill two (1.3 net) wells on the farm-in lands. The farm-in is subject to a non-performance penalty of $0.5 million per well. The total estimated net cost of the drilling commitment is $1.95 million.

At December 31, 2007, the Company was committed to future payments totalling $45,654 for office space rental, a proportionate share of operating costs, and office furnishings for the first six months of 2008. Subsequent to December 31, 2007, the Company committed to another office lease and future payments for rental of office space and a proportionate share of operating costs resulting in combined future commitments as follows:

		Amount
2008	$	216,436
2009		341,563
2010		341,563
2011		341,563
2012		341,563
2013		170,781

13. FINANCIAL INSTRUMENTS

The fair values of the Company's term deposits, accounts receivables, accounts payables and accrued liabilities approximate their carrying amounts due to the short-term nature of these financial instruments.

The Company's accounts receivables are primarily with industry competitors and are subject to normal industry credit risks. As the Company extends unsecured credit to these entities, the collection of any receivables may be affected by changes in the economic environment or other conditions. Management believes the risk is mitigated by the financial position of the entities, and the Company's practice of requesting cash call advances for funds estimated to be incurred.

While all of the Company's sales are denominated in Canadian dollars, the market prices in Canada for oil and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar.

At December 31, 2007, the Company had no fixed price contracts or financial instruments associated with future production.

Period ended December 31, 2007

14. SUBSEQUENT EVENT

Subsequent to year end, the Company entered into an agreement to acquire certain natural gas properties in northeast British Columbia (the "Assets"). The consideration for the acquisition consists of 4,110,000 Class A shares of Painted Pony issued at $4.33 per share and approximately $3.0 million cash, for a total purchase price of $20.8 million, before closing adjustments and related costs. The shares are subject to certain terms, restrictions and conditions until March 31, 2009. The acquisition has an expected closing date of March 31, 2008. The completion of the acquisition is subject to certain conditions including normal regulatory approvals, including approval of the TSX Venture Exchange.

BOARD OF DIRECTORS

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Calgary, Alberta

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Calgary, Alberta

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Patrick R. Ward
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Painted Pony Petroleum Ltd.
Calgary, Alberta

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Vice President, Geology

Douglas McCartney
Partner, Burstall Winger LLP
Corporate Secretary

Mary Kay Axford
Controller

EXCHANGE LISTING

TSX Venture Exchange
Trading symbols:
Class A Shares: PPY.A
Class B Shares: PPY.B

LEGAL COUNSEL

Burstall Winger LLP

AUDITORS

KPMG LLP

BANKERS

National Bank of Canada

EVALUATION ENGINEERS

McDaniel & Associates Consultants Ltd.

REGISTRAR AND TRANSFER AGENT

Olympia Trust Company
Calgary, Alberta
1 800 727-4493
Enquiries:
cssinquiries@olympiatrust.com

HEAD OFFICE

402, 620 - 12 Ave SW
Calgary, Alberta T2R 0H5
Toll Free Investor: (866) 975-0440
Phone: (403) 475-0440
Fax: (403) 238-1487
Email: info@paintedpony.ca
www.paintedpony.ca

Designed by Sandy Seifert Printed by Unicom Graphics

PAINTED PONY
PETROLEUM LTD.

402, 620 - 12 Ave SW Calgary, Alberta T2R 0H5
Phone: (403) 475-0440 Fax: (403) 238-1487
Toll Free: 1-866-975-0440
www.paintedpony.ca